PRECOMPUTED:

A precomputed account is one in which the debt is expressed as a sum comprising the principal and the amount of the finance charge computed in advance.

The total amount of each payment is subtracted from the balance which includes the principal and finance charges (interest).

SIMPLE INTEREST:

A simple interest (interest bearing) account is one in which the balance includes only the principal amount and the interest calculated from payment date to payment date is subtracted from the total amount of the payment and the remainder of the payment is subtracted from the principal balance.

A precomputed account and a simple interest account with the same amount financed or principal balance, the same annual percentage rate and the same terms will have the same finance charge. If both accounts have payments made as contracted for the full term of the obligation, the finance charge will be the same for both accounts.

DIFFERENCES:

The differences between the two accounts are in how payments to the accounts are actually made during the term

Delinquency Charges: Both types of accounts can have delinquency charges imposed if payments are not received within 10 days of the date the payment is due. On a simple interest account you will also be paying interest for the days delinquent on a higher balance than the original total finance charge was computed, making you pay more finance charges than originally contracted.

If you were over 10 days late in making your payments each month on an account with a \$5,000 original unpaid balance with a 21% annual percentage rate for 24 months, you would pay \$372.00 in delinquency charges on a precomputed account.

You would have paid the \$372 00 delinquency charges plus additional interest (finance charges) on any unpaid delinquency charges and the higher principal balance due to the delinquency on a simple interest account.

Deferral Charges: Precomputed accounts can have a deferral charge imposed, if contracted for, on payments past due over 10 days. Deferral charges are based on the balance deferred times the annual percentage rate divided by 12.

Deferral charges are not allowed on simple interest accounts. However, you would be paying a higher finance charge then originally contracted if your payments were delinquent or the lender allowed you to make an "interest only" payment.

As you can see from the example above, being delinquent in your payments can be very costly over the term of an account

plus being delinquent is reported on your credit records and future credit may be hard to secure.

Prepayments: When you prepay a simple interest account, you owe the principal balance plus interest accrued since the previous payment. There is no rebate. When you want to pay off a precomputed account ahead of your contractual obligation, you are entitled to a rebate of the unearned finance charge based on the sum of the balances known as the Rule of 78's.

The Rule of 78's is so named because a hypothetical installment account with a term of 12 months has 78 units calculated by adding the numbers 1 plus 2 plus 3 through 12. To compute the Rule of 78's decimal you take the number of months remaining in the term of the contract times that number plus 1. You divide that number by the number of months in the term times the term plus 1. The Rule of 78's decimal is then taken times the finance charge to compute the rebate.

EXAMPLE:

\$5,000.00 amount financed \$1,166.32 finance charge 24 payments of \$256.93 21% annual percentage rate Date made 1-10-00 First payment due 2-10-00 Date prepaid 11-11-00

There are 11 months earned on the account (the creditor can take a full months earnings for 1 day into the next month) and 13 months unearned. You can compute the rebate as follows

13 X 14 divided by 24 X 25 = 182 divided by 600 = .3033 Rule of 78's decimal

\$1.166.32 X .3033 = \$353.74

The finance charge rebate would be \$353.74.

The lender earned 69.67% of the total finance charge during the first 11 months of the 24 month contract. Finance charges earned by the Rule of 78s are the highest for the first months of the term because the balance of the amount financed is highest during that period.

You can look at the chart on the next page to see that the earned finance charge would be \$812.54 after 11 months.

A simple interest account with the same terms which was paid on the contracted due date each month and prepaid on 11/11/00 would have finance charges earned of \$737.10, the unearned finance charge would be \$429.22 (earning on for 10th month plus one day's interest) which is \$75.48 less total finance charges then the precomputed account.

If the account had prepaid on 11/10/00 (exactly 10 months), the total finance charge on the precomputed account would have been \$758.11 (\$1,166.32-408.21). this is still \$22.96 more then the simple interest earned finance charge of \$735.15 (\$1,166.32-431.17).

From the examples given, you can see that if you make your payments as contracted each month and prepay your account, a simple interest account will cost you less than a precomputed account.

If you do not pay your account in full before the maturity date and pay as contracted for the full term of the account, there would be no difference in the cost between a precomputed account and a simple interest account. On the other hand, if you are constantly delinquent on your payments, a simple interest account will result in higher finance charges.

There are also various types of simple interest accounts such as fixed rate or variable rate. You can generally get a variable rate account at a slightly lower annual percentage rate then a fixed rate account, however the variable rate is subject to change as provided in your contract and could go higher or lower depending on the index the variable rate is based on such as the prime rate.

It is almost impossible to be able to tell whether a variable rate will have less finance charge then a fixed rate account. History has indicated it may be best to take a fixed rate account when interest rates are running lower and when the interest rates go higher, consider a variable rate as the rates may go back down and the variable rate account would have less finance charge in the long run than a fixed rate account.

On large mortgage loans for a home that you would not be planning on keeping for the full term, the variable or adjustable rate may be better. Many lenders have lower adjustable rates for the first year or more of a loan and usually there are caps on how much the rate can increase each year. If you purchase a home that you plan to remain in, a fixed rate may be best. If rates do go lower, you can consider refinancing your mortgage to a lower fixed rate.

Be aware that on variable rate simple interest smaller loans, some lenders do not increase or decrease the monthly payments when the rates increase or decrease. They contract for a larger or smaller final payment or more monthly payments. If rates increase, you could owe up to hundreds of dollars at the end of the term when you think your account would be paid. Be sure to read and understand all the provisions on a variable rate transaction.

REMEMBER... Make sure you know what type of loan you make. If you make a precomputed loan and prepay in full before the end of the term, make sure you get a rebate of the unearned finance charge.

If you make a simple interest loan, finance charges are not included in the balance and there is no rebate if you prepay.

The Indiana Department of Financial Institutions, Division of Consumer Credit has many other credit related brochures available, such as:

> Answers to Credit Problems Applying for Credit At Home Shopping Rights Bankruptcy Facts Buried in Debt Car Financing Scams Charge Card Fraud Choosing A Credit Card Co-Signing Credit and Divorce Credit and Older Consumers Deep in Debt? **Equal Credit Opportunity** Fair Credit Reporting Fair Debt Collection **Gold Cards** Hang up on Fraud High Rate Mortgages Home Equity Credit Lines How to Avoid Bankruptcy Indiana Uniform Consumer Credit Code Look Before you Lease Mortgage Loans Repossession Reverse Mortgage Loans Rule of 78s – What is it? Scoring for Credit Shopping for Credit **Using Credit Cards** Variable Rate Credit What is a Budget?

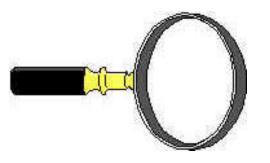
Call our toll-free number or write to the address on the cover for a copy of any of the brochures listed or for further consumer credit information.

What is the DFI?



DEPARTMENT OF FINANCIAL INSTITUTIONS Consumer Credit Division 30 South Meridian Street, Suite 300 Indianapolis, Indiana 46204

PRECOMPUTED Vs SIMPLE **INTEREST LOANS**



DEPARTMENT OF FINANCIAL INSTITUTIONS

Consumer Credit Division 30 South Meridian Street, Suite 300 Indianapolis, Indiana 46204 317-232-3955 1-800-382-4880

